

# Procurement Exceptions



January 12, 2016  
Board Meeting



# Board Charter Contracts

***“The sponsor of a charter school may contract with a public body, private person or private organization for the purpose of establishing a charter school pursuant to this article.” [A.R.S. §15-183(B)]***

- Current Board Charter Contracts (N=426)
  - Non-Profit Entities = 391 (91.8%)
  - For-Profit Entities = 30 (7.0%)
  - Government Entities = 5 (1.2%)
- 501(c)(3) Status Not Tracked

# Portfolio Characteristics

- Board Sponsored School Sites by FY15 ADM (N=539)
  - Less than 150 ADM = 222 (41.2%)
  - 150 to 300 ADM = 145 (26.9%)
  - 301 to 600 ADM = 110 (20.4%)
  - 601 to 999 ADM = 50 (9.3%)
  - More than 1,000 ADM = 12 (2.2%)

**Source:** Fiscal year 2015 100<sup>th</sup> Day ADM (Arizona Department of Education)

- Charter Holders' FY15 Total Expenses Range from Approximately \$160,000 to \$32 million

**Source:** Determined by staff based on fiscal year 2015 ADM and audit information

- Current Exceptions Granted by Board (as of 12/15/15)
  - Procurement exception = 391 (91.8%)
  - No procurement exception = 35 (8.2%)

# Authority to Contract

***“Charter schools may contract, sue or be sued.”***

***[A.R.S. §15-183(H)]***

- Could Include Facilities, Individual Services, or Contracting with Education Services Provider to Provide Comprehensive Services
- Education Services Provider (ESP)
  - Major types of charter school ESPs include charter management organizations (CMOs), education management organizations (EMOs), and comprehensive school design providers
  - New application includes specific submission requirements for applicants that intend to contract or have a governance relationship with an ESP
  - ESP status also addressed in replication application process

# Procurement Regulations

- Board's [Procurement Compliance Questionnaire](#)
  - Systematic review of purchasing practices [A.R.S. §15-213(F)]
    - Applicable to “school districts, nonexempt charter schools and school purchasing cooperatives”
    - See highlighted portion of compliance questionnaire (hyperlink above)
  - “Disbursements” [Uniform System of Financial Records for Charter Schools]
    - Among other items, addresses oral and written price quotations
    - See non-highlighted portion of compliance questionnaire (hyperlink above)
- Current Charter School Procurement Thresholds
  - Oral price quotations = At least \$10,000 but less than \$50,000
  - Written price quotations = At least \$50,000 but not exceeding \$100,000
  - Competitive sealed bids/proposals = More than \$100,000

# Exception Authority

*“The charter of a charter school shall...[e]nsure that, except as provided in this article, it is subject to the same financial and electronic data submission requirements as a school district, including the uniform system of financial records as prescribed in chapter 2, article 4 of this title, procurement rules as prescribed in section 15-213 and audit requirements. ... A school’s charter may include exceptions to the requirements of this paragraph that are necessary as determined by the district governing board, the state board of education or the state board for charter schools.”*

**[A.R.S. §15-183(E)(6)]**

- Sponsor’s authority to grant exceptions included as provision of original charter law (1994)

# Exception Authority

***“Notwithstanding subsection A, the state board for charter schools may authorize an exemption from public bidding requirements that exceeds the maximum exemption prescribed in subsection A of this section for any charter school sponsored by the state board for charter schools.” [A.R.S. §15-189.02]***

- “Subsection A”
  - Exempts a charter school's procurement from public bidding requirements if the procurement's aggregate dollar amount does not exceed the maximum amount of the exemption authorized by Title 41, Chapter 23 or rules adopted by the Department of Administration
  - Current maximum exemption = \$100,000 [A.R.S. §41-2535]
- Law enacted in 1996

# Exception Authority

- Exception Applies Only to State Procurement Regulations (Federal Requirements Still Apply)
- Exception Becomes Part of Charter Contract
  - Board currently unable to unilaterally rescind exception once granted
  - Exception could be rescinded as part of settlement/consent agreement
- Nearly 92% of Board's Charters Have Exception



# Chronology of Events

## **Charter Requests Exception**

Benjamin Franklin Charter School, Ltd. requested that its contract be amended to include an exception from procurement rules.



May  
1997

## **Exceptions Continued**

Board President suggested that the Board continue to except schools, upon request, from procurement laws, which subsequent minutes show occurred.



September  
1997

## **Exceptions Removed from New Application Process**

Board approves 2004-2005 application. Under this application, exceptions are no longer provided through the application process.



May  
2003

## **First Exception Granted**

After discussion and public input at its May and June meetings, the Board granted its first procurement exception and established a 1-year pilot program not to exceed 5 exceptions.



## **Exceptions Granted thru New Application Process**

Board approves 1999-2000 application. This application appears to be the first that allowed the applicant to request and receive an exception through the new application process.



February  
1998



# Chronology of Events

## **Exceptions Put on Hold**

Approval of exceptions put on hold while a sample procurement policy was developed. Board began granting exceptions again in May 2004.



January  
2004

## **'New Charter' Exceptions Reviewed**

Board subcommittee considered changing policy to require a year of operations before granting exceptions. Subcommittee determined change was not needed.



May  
2006

## **Exception Requests Tabled**

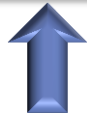
Board tabled procurement exception requests and held a study session in January to explore whether any changes should be made. No changes made.



November  
2012

## **Form and Policy Clarified**

Amendment request form and sample policy modified to emphasize that the exception applies only to state – and not federal – procurement requirements.



November  
2005

## **'Best Interest of School' Added to Sample Policy**

Board revised sample policy to make sure that regardless of how school does its procurement it is done in the best interests of the school and not just the best judgment of the procurement officer.



June  
2006



# Current Exception Process

- Charter Holder Submits Amendment Form, Meeting Minutes, and Policy for Procuring Goods/Services
- Staff Reviews Request & Board's Eligibility Criteria
  - No current 10% withholding for failure to timely submit most recent audit
  - In “good standing” with Arizona Corporation Commission
  - If applicable:
    - Received notification that current FY audit CAP has been completed
    - Have a “compliant” status reflected on ADE's Grants Management website for each grant for the past four years
    - Be current in submitting employer and employee contributions and reports to the Arizona State Retirement System
- Request Placed on Board's Consent Agenda

# Creation of Sample Policy

- Initial Exception Process Required Charter Holder Notify Board of Its Alternative Procurement Process
  - No established guidance for alternative processes
  - Processes submitted by charter holders ranged from one sentence to several pages
- Sample Procurement Policy Developed in 2004
  - General, simple statement created intentionally to:
    - Provide a framework for making procurement decisions
    - Provide a framework for supporting those decisions
  - Using Board's sample policy does not preclude adopting additional procurement-related policies and procedures for internal use
- Next Five Slides Walk Through Provisions of Board's Current Sample Policy Template

# Sample Policy Provisions

***“XX charter school will follow accounting policies and procedures that comply with generally accepted accounting principles (GAAP).”***

- Adherence to GAAP Required by Charter Contract or through Amendment
- What Is GAAP?
  - Uniform minimum standards for financial accounting and reporting that govern the form and content of an entity's financial statements
  - Principles encompass conventions, rules and procedures necessary to define accepted accounting practices at a particular time
  - Primary authoritative body on GAAP's application for most charter holders is the Financial Accounting Standards Board (FASB)

# Sample Policy Provisions

*“Any procurement of goods and services shall be made by the procurement officer/authorized agent, in the best interest of the school, upon considering the totality of the circumstances surrounding the procurement, which may include but not be limited to, price, quality, availability, timelines, reputation and prior dealings.”*

- Applies to Any Procurement
  - Doesn't stipulate procurement thresholds
  - Accommodates charter school diversity
- Emphasizes “Best Interest of the School”
- Recognizes Multiple Factors May Affect Decision

# Sample Policy Provisions

*“XX charter school shall not purchase any goods or services from any member of the governing board, an immediate family member of any member of the governing board nor from any entity in which any member of the governing board or an immediate family member of a governing board member may benefit from such a procurement, unless authorized by the governing board after a full disclosure of the potential benefits, and after the consideration set forth in paragraph 1 above.”*

- Please see next slide for additional information

# Sample Policy Provisions

- Applies to All Purchases Involving Specified Parties
  - Collectively, the individuals and entities mentioned in this provision may also be referred to as “related parties”
  - No thresholds established intentionally
- Requires Governing Board Authorization
- Requires Full Disclosure
  - Potential benefits to charter school
  - Consideration of factors identified previously
    - Best interest of the school
    - Price, quality, availability, timelines, reputation, and prior dealings



# Sample Policy Provisions

***“XX charter school understands that the policy cited above applies to purchases made using non-federal funds. As a condition of the receipt of certain federal funds, federal procurement requirements still apply.”***

- Language Added to Policy in 2005
  - Change resulted after conversations with ADE federal program staff
  - Board's exception authority applies to State procurement regulations
  - Revision made to remind those seeking an exception that:
    - The exception applies only to purchases using non-federal funds
    - Federal procurement requirements would apply to purchases made using certain federal funds
- Amendment Form Also Revised

# Certain IRS Requirements

- Applicable to 501(c)(3) Charter Holders Only
- Private Inurement Prohibition
  - No part of 501(c)(3) organization's net income can inure to the benefit of those that control the organization
  - 501(c)(3) organization must be organized and operated exclusively for exempt purposes by serving public rather than private interests
- Excess Benefit Transaction
  - A transaction in which an economic benefit is provided by a 501(c)(3) organization, directly or indirectly, to or for the use of a disqualified person, and the value of the economic benefit provided by the organization exceeds the value of the consideration received by the organization.
  - Disqualified persons include: a) person in a position to exercise substantial influence over organization's affairs; b) family member of an individual identified in "a)"; or c) entity in which individuals described in "a)" or "b)" own more than a 35 percent interest.

# Certain IRS Requirements

- *Return of Organization Exempt from Income Tax*
  - Also known as the Form 990 or simply the 990
  - Provides information to IRS and public about how organization operates
  - Filed annually by 501(c)(3) organizations, including charter holders
  - Must be available for public inspection
    - Most can be found online at [www.guidestar.org](http://www.guidestar.org)
- Among Other Information, Form 990 Includes:
  - Compensation of officers, directors, trustees, key employees, highest compensated employees and independent contractors
  - Loans from the organization to certain persons or vice versa
  - Certain direct and indirect business transactions between the organization and current or former governance and management officials of the organization or their associated businesses/family members
  - Excess benefit transactions that the organization engaged in
  - Governing body and management disclosures

# Auditing Standards

- Generally Accepted Auditing Standards (GAAS)
  - Guidelines for how financial audits are to be conducted
  - Audit conducted under GAAS includes auditor's opinion on whether the entity's financial statements are presented in accordance with GAAP
  - American Institute of Certified Public Accountants' Auditing Standards Board is primary authoritative body on GAAS
- Government Auditing Standards (GAS)
  - A.R.S. §15-914 requires charter audits be conducted under GAS
  - GAS adds additional considerations to GAAS
  - Standards pertain to auditors' professional qualifications, quality of audit effort, and reporting requirements, including compliance with certain provisions of laws, regulations, contracts and grant agreements
  - GAS issued by the Comptroller General of the United States

# Related Party Transactions

- GAAP Requires Related Party Transaction Disclosure
  - Entity's financial statements must disclose info about these transactions
  - Transactions could include borrowings, guarantees, services received even if services provided without charge
  - Related party transactions cannot be presumed to be at arm's length
- Under GAAS, Auditor Required to Evaluate Adequacy of Related Party Disclosures
  - Audit procedures include:
    - Determining existence of related parties
    - Identifying transactions with related parties
    - Examining identified related party transactions
    - Determining sufficiency of disclosures
  - Financial statements must disclose material related party transactions
    - Disclosure includes nature of relationship involved, transaction description, dollar amount, and any balance due
    - No standard definition for materiality; involves auditor judgment

# Annual Charter Audits

- Financial Statement Audit Reporting Package
  - Financial statements including auditor's opinion
  - GAS report on internal control and compliance
    - Report includes any findings required to be disclosed by standards
    - Findings could include material weaknesses & significant deficiencies
  - Applicable compliance questionnaire(s) (Applicability depends upon exceptions received)
    - Legal Compliance Questionnaire
    - USFRCS Compliance Questionnaire
    - Procurement Compliance Questionnaire
  - Management letter issued by auditor, if applicable
- Procurement Exception's Effect on Audit
  - GAAS and GAS apply regardless of whether exception granted
  - For charters with procurement exception, auditor completes either the Legal Compliance Questionnaire or USFRCS Compliance Questionnaire
  - Currently, these questionnaires do not include questions regarding related party transactions or charter holders' procurement practices

# What Do Audits Show?

- Not All Schools Have Related Party Transactions
- Charter School Related Party Transactions Include:
  - Zero percent interest loans
  - Personal guarantees on lines of credits/loans with financial institutions
  - Forgiveness of amounts owed for services provided
- In Some Cases, Related Party Audit Findings
  - Control environment
    - Individual & wife's company contracted to provide the same services
    - Payment to related party in advance of receipt of services
    - Insufficient documentation to support related party transactions
    - Weaknesses in other accounting and disbursement practices
  - Violations of IRS requirements
    - Failure to file Form 990
    - Purchase of van for nearly twice its Kelly Blue Book value
    - Vehicle lease amount or loan interest rate considered "excessive"

# Audit Issue Follow-up

- Board Policy Guides Audit Issue Follow-up
  - [Audit & Compliance Questionnaire Follow-up Matrix](#)
  - Matrix classifies audit issues into three categories – minimal impact findings, medium impact findings, and serious impact findings
- All Audits Reviewed Pursuant to Administrative Rule and in Accordance with Board's Matrix
  - Each charter holder receives a letter after audit has been reviewed
  - Depending on the “impact” of the issues identified, the letter may:
    - Indicate that the charter holder should work towards correcting the issues and that staff will monitor for repeated issues in the next audit;
    - Indicate that the audit included repeated issues that had not been addressed from the prior year's audit;
    - Require the charter holder to submit a corrective action plan; and/or
    - State that the charter holder will be placed on the next Board agenda for possible disciplinary action.



# Audit Issue Follow-up

- Control Environment
  - Staff requests corrective action plan
  - Per matrix, staff monitors subsequent audits for “second” and “third” time
- Violations of IRS Requirements
  - For most issues, audit letter states that matter will be referred to the IRS
    - Staff sends written communication to the IRS
    - Staff monitors subsequent audits
  - When the charter holder fails to file its Form 990, staff follows the process identified in the “Control Environment” section above
- Procurement Compliance Questionnaire
  - Staff monitors for repeated issues in next year’s audit
  - Issues identified in 3+ consecutive years noted in operational dashboard

# Communication with Charter Representatives

- Prior to the Board's January 2013 Study Session, Staff Asked Charter Holders to Provide the Following:
  - Examples of the circumstances under which the exception has afforded your organization the opportunity to procure goods or services that would have otherwise been more expensive or less timely, etc.
  - Policies to ensure that the procurement of goods and services is in the best interest of the school.
- Next 3 Slides Include the Responses Staff Received in Advance of the January 2013 Study Session

# Sentiments Shared

- The bond between venders and buyers is an important one and when a good relationship has been created it is important to not put them through the ringer each time a new contract comes up. However, this does not mean that we do not on a regular basis just make sure that who we are using is in alignment with the market expectations. That can be done without a huge bid process and is just sound business practice.
- Following existing 501C3 non-profit regulations that we are already subject to should cover any concerns around board members improperly profiting from a charter school.
- Board members and employees almost always go out of their way and give the best deals possible
- Cost-saving and timely procurement activities actually save tax-payer dollars and are guided by policies that stipulate sharable, transparent, and ethical purchasing, as well as full disclosure of potential benefit.
- I think it would be a mistake to change what is working so well for so many charter schools.
- The idea and purpose behind the charter school philosophy is to empower educational entrepreneurs to create a different program and run it like a business and produce results, and we have done that.
- I feel that requiring charter schools to follow similar procurement policies as district schools are required to follow would substantially increase the cost of doing business and decrease the efficiency of our organizations.
- The procurement exemption is one of the main reasons why we exist today and have a successful school. We save considerable funds and are able to make our dollars stretch because local businesses and community members will provide services at a lower cost than we can obtain them from surrounding areas.

# Examples of Cost Savings

- The ability to build new schools that meet all quality and compliance standards quickly and more economically than the typical school district. According to the Arizona School Facilities Board, the school construction costs for 2008 (latest figures available) for a 5-12 school are \$153.77 per square foot. We have built six schools over the past three years at less than \$100 per square foot.
- IT installation and support, web and media design, campus custodial/maintenance/landscaping, and vehicle upkeep can be expensive service areas which have been done voluntarily or at cost only.
- In 2007, we built an addition, which we got 3 bids on because it makes good business sense. Then last year, we needed to make some improvements based on use of the new space, which cost around 68,000 dollars. It was so nice to be able to go back to the construction company that put up the addition and just have them make the changes without having to go out to bid AGAIN! We had developed a relationship and I know we got a really good deal the second time around.
- Much of our financial success has to do with being able to shop sales and bargains, dollar stores, thrift shops, second hand stores, auctions and take advantage of personal connections.

# Examples of Cost Savings

- One of our big construction projects, our gymnasium, would have cost three times as much if we had not been able to purchase the metal building from a family connection. By purchasing the steel building directly from the manufacturer and then finding a local contractor for the construction, we came in at about one-third the cost of any of the local contractors.
- We can still use all the standard government approved suppliers, but we can also purchase from any place where we get the best price. Some of those best prices are sales that we have to grab right away because they would be over before we could go through the bid process.
- A copier rep showed me several options for copiers once. When I said we had an exemption to the procurement code and could purchase off contract, the rep said, "Well, in that case I have these models that will cost you half."
- We have found one General Contractor who is very reliable, does great work, and even comes in emergencies to step in when some other company screws up. He is not related to anyone here, yet we also do not bid out against him and his offers because we have developed a good working relationship.
- We were helped in buying our building by a board member who is not a family member. These board members volunteered all their management hours for free to help us through the process of our buildout. We had a lot of changes we needed to make. There was a lot of time down at the city working with the inspectors and we were never billed for that time. The construction was done by the same companies that the board members used to do the rebuild on their own commercial real estate. If we had had to bid out to three contractors for this job then it would have been impossible to get it done in time.